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TO: **Management of Kansas chartered credit unions**

SUBJECT: **Interest Rate Risk**

The Federal Reserve recently lowered interest rates in response to problems in the sub-prime mortgage market. These problems have created a subsequent effect of lowering the value of bonds whose underlying collateral are these mortgages. The yield curve is usually slow to recognize short-term rates changes effect on longer-term rates.

For credit unions of all asset sizes, this emphasizes the importance of pricing loans and shares correctly. While every credit union's circumstances are different, the importance of timely adjustments in interest and dividend rates cannot be overly stressed. The result of not appropriately adjusting rates will affect liquidity and cost of funds.

Eliminating interest rate risk is not the goal but managing the risk is essential to a sound operation. WHEN, not if, interest rates will change is the question. If the credit union has a strong asset/liability management program and is managing interest rate risk, the 'when' is not important. Credit unions should consider steps now to mitigate their risk:

- Determine your board of directors' risk tolerance. The board needs to identify its risk tolerance and provide operating management direction for working within these limits. The board's tolerance can often be stated in the amount of net worth the board is willing to lose. Quantifying this level can be done by adopting a minimum capital level after 'shocking' the balance sheet.
- Analyze the credit union's position. Management must determine the current position. Rather than simply grouping all investments or all loans together, a sound analysis reviews the characteristics of each category with in the group. Review maturity, caps, floors, adjustment periods, call dates, and other identifying characteristics of each subcategory of investments and loans.
- Study the options. Once the current position is reviewed, the balance sheet should be 'shocked' to determine the potential effect of interest rate movement. If the results are not within the board of directors determined risk tolerance, management should determine a course of action to bring the balance sheet into line with the board's comfort level. Periodic review and continual restructuring of investments or loans will permit a gradual change in assets. This is much preferable to a sudden, more drastic shift that could have detrimental results.

In summary credit union of all asset sizes boards of directors should review interest and loan rates at every board meeting. Operating management may want to review rates more frequently.

/s/
John P. Smith, Administrator October 22, 2007

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